
CHAPTER III. BASELINE REVENUE PROJECTIONS

Federal revenues under current law are projected to be \$606 billion in 1983, \$12 billion below the amount collected in 1982. This is the first time since 1971 that there has actually been a decrease in revenues. This decrease--attributable to the combined effects of the current recession and the major tax cuts enacted in 1981--lowers the starting point for the 1984-1988 baseline revenue projections.

Baseline revenues are projected to resume their growth as the economy recovers, rising to \$653 billion in 1984 and reaching \$878 billion by 1988 (see Table 9). As a percentage of gross national product, however, revenues are projected to decline slightly, from 18.7 percent in 1984 to 18.3 percent in 1988. This is well below the post-World War II high of 20.9 percent of GNP reached in 1981, and returns revenues as a percentage of GNP to approximately the levels that prevailed in the 1960s and 1970s. The major reason for this drop over the projection period from the 1981 high is the large tax reductions enacted in the Economic Recovery Tax Act of 1981 (ERTA), reductions that were only partly offset by the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA). Without ERTA and TEFRA, revenues during the 1980s would have moved well above the all-time record of 21.9 percent of GNP reached in 1944.

The recession has also had a major effect on projected revenues. This can be illustrated by comparing CBO's current baseline revenue projections with those made in July 1981, just before the onset of the recession. If revenues under the tax law now in effect are projected using the optimistic economic assumptions adopted in July 1981 by the conferees on the first budget resolution for fiscal year 1982, revenues for the 1983 through 1986 period would be over \$700 billion higher than they are now projected to be.

DEFINITION OF BASELINE REVENUES

Baseline revenues are revenues generated under existing tax law. There is one exception to this rule: airport and airway trust fund taxes are assumed to be extended at current rates beyond the present expiration date of December 31, 1987. These airport and airway taxes increase revenues in fiscal year 1988 by a net of \$2.6 billion.

TABLE 9. BASELINE REVENUE PROJECTIONS BY SOURCE
(By fiscal year, in billions of dollars)

	1982 Actual	1983 Base	Projections				
			1984	1985	1986	1987	1988
Individual Income Taxes	298	286	295	321	346	372	400
Corporate Income Taxes	49	40	56	65	74	83	88
Social Insurance Taxes	201	212	232	258	283	303	326
Excise Taxes							
Windfall profit taxes	19	14	13	12	10	9	9
Other	17	23	28	30	26	26	27
Estate and Gift Taxes	8	6	6	6	5	5	4
Customs Duties	9	9	10	10	10	11	11
Miscellaneous Receipts							
Federal Reserve payments	15	14	12	13	12	12	12
Other	<u>1</u>	<u>1</u>	<u>1</u>	<u>1</u>	<u>1</u>	<u>1</u>	<u>1</u>
Total Baseline Revenues	618	606	653	715	768	822	878

All other provisions of existing tax law that are scheduled to expire during the projection period are assumed to expire on schedule. These provisions include some of the energy tax credit provisions enacted in the Energy Tax Act of 1978 and the Crude Oil Windfall Profit Tax Act of 1980, and the temporary increases in cigarette and telephone excise taxes enacted in TEFRA, among others. A compilation of the tax provisions with expiration dates during the projection period is provided in Appendix E.

Provisions that are scheduled to expire during the projection period have a relatively small net effect on the projections. The scheduled expiration of a number of revenue-raising provisions reduces projected 1988 revenues by about \$4 billion, but this is more than offset by the scheduled expiration of a large number of revenue-losing provisions, which raises 1988 revenues by about \$17 billion, resulting in a net increase in 1988 revenues of about \$13 billion. The following sections describe how the tax structure has changed since 1960 and how it is projected to change in 1983-1988.

THE CHANGING FEDERAL TAX STRUCTURE

As mentioned above, revenues in fiscal year 1983 are estimated to be \$12 billion below revenues collected in 1982 (Table 9). The principal factors accounting for the reduction in 1983 revenues below the 1982 level are the third round of the across-the-board individual income tax rate reductions in combination with the depressed levels of personal income growth and drastically reduced profits brought on by the recession, and the significant decrease in windfall profit tax revenues in 1983 attributable, for the most part, to the drop in oil prices. Growth in revenues is expected to resume in the 1984-1988 period but at rates slightly below the expected growth of the economy as a whole. Hence, federal revenues as a percentage of GNP will continue to decline.

Total federal revenues as a percentage of GNP rose from an average of 18.6 percent in the 1960s to 18.9 percent in the 1970s, with a steady decline in corporate income taxes being more than offset by a sharp increase in social insurance taxes and a modest increase in individual income taxes. Revenues as a percentage of GNP moved up significantly in the late 1970s and early 1980s, however, reaching 20.9 percent of GNP in 1981. Individual income taxes, which averaged 8.2 percent of GNP in the 1960s and 8.6 percent in the 1970s, reached 10.0 percent in 1981, matching the previous high set in 1944. Social insurance taxes as a percentage of GNP increased sharply from an average of 3.6 percent in the 1960s to 5.3 percent in the 1970s and 6.4 percent in 1981. Corporate income taxes, by contrast, fell from 4 percent of GNP in the 1960s to just under 3 percent in the 1970s and to 2.1 percent in 1981 (see Table 10).

Individual income taxes rose as a percentage of GNP in the late 1970s and early 1980s because legislated reductions in income taxes did not fully offset the increases that resulted as inflation pushed taxpayers into higher tax brackets (so-called "bracket creep"). Social insurance taxes as a share of GNP rose mainly because of the large Social Security payroll tax increases enacted in 1977 to fund projected increases in Social Security benefit payments. Corporate income taxes as a percentage of GNP fell over the period partly because of a steady decline in corporate profits as a share of GNP, but also because of a series of legislated reductions in corporate income taxes, most of which took the form of investment tax credits, increases in depreciation allowances, and other special exclusions, deductions, and credits. The top corporate tax rate was also reduced from 48 percent to 46 percent in 1978.

TABLE 10. FEDERAL REVENUES BY SOURCE, AS A PERCENTAGE OF GNP
AND OF TOTAL REVENUES, 1980-1988 (By fiscal year)

Revenue Source By Type of Tax	Actual			1983	Baseline Projection				
	1980	1981	1982		1984	1985	1986	1987	1988
As a Percentage of GNP									
Individual Income	9.5	10.0	9.8	8.9	8.4	8.4	8.3	8.3	8.3
Corporate Income	2.5	2.1	1.6	1.3	1.6	1.7	1.8	1.9	1.8
Social Insurance	6.1	6.4	6.6	6.6	6.6	6.8	6.8	6.8	6.8
Excise	0.9	1.4	1.2	1.2	1.2	1.1	0.9	0.8	0.7
Estate and Gift	0.2	0.2	0.3	0.2	0.2	0.1	0.1	0.1	0.1
Other	<u>0.8</u>	<u>0.8</u>	<u>0.8</u>	<u>0.8</u>	<u>0.7</u>	<u>0.6</u>	<u>0.6</u>	<u>0.5</u>	<u>0.5</u>
Total	20.1	20.9	20.4	19.0	18.7	18.7	18.5	18.4	18.3

As a Percentage of Total Revenues									
Individual Income	47.2	47.7	48.3	47.2	45.1	44.9	45.0	45.2	45.6
Corporate Income	12.5	10.2	8.0	6.6	8.5	9.1	9.6	10.1	10.0
Social Insurance	30.5	30.5	32.6	35.0	35.5	36.1	36.9	36.9	37.1
Excise	4.7	6.8	5.9	6.2	6.4	5.8	4.7	4.3	4.1
Estate and Gift	1.2	1.1	1.3	1.0	0.9	0.8	0.7	0.6	0.5
Other	<u>3.9</u>	<u>3.7</u>	<u>4.0</u>	<u>4.0</u>	<u>3.5</u>	<u>3.3</u>	<u>3.1</u>	<u>2.9</u>	<u>2.7</u>
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Effects of ERTA and TEFRA

The Economic Recovery Tax Act of 1981 reversed the upward trend of individual income taxes as a share of GNP, and further accelerated the downward trend in corporate income taxes as a share of GNP (see Table 11). ERTA is projected to reduce individual income taxes below what they would otherwise be by 3.0 percent of GNP in 1984 and by 4.5 percent in 1988. Corporate income taxes are projected to be reduced by 0.7 percent of GNP in 1984 and 0.9 percent in 1988. The ERTA tax reductions taken together are projected to reduce total revenues by 3.9 percent of GNP in 1984 and 5.6 percent in 1988.

TABLE 11. REVENUE EFFECTS OF THE ECONOMIC RECOVERY TAX ACT OF 1981
(By fiscal year)

	1982 Actual	1983 Base	Projections				
			1984	1985	1986	1987	1988
In Billions of Dollars							
Individual Income Taxes	-29	-68	-105	-126	-155	-182	-213
Corporate Income Taxes	-9	-17	-26	-34	-42	-45	-43
Social Insurance Taxes	<u>a/</u>	<u>a/</u>	<u>a/</u>	<u>a/</u>	<u>a/</u>	<u>a/</u>	<u>a/</u>
Excise Taxes							
Windfall profit taxes	-1	-1	-1	-1	-1	-1	-1
Other	---	1	1	<u>a/</u>	---	---	---
Estate and Gift Taxes	<u>a/</u>	<u>-2</u>	<u>-4</u>	<u>-5</u>	<u>-6</u>	<u>-8</u>	<u>-10</u>
Total	-38	-88	-135	-167	-205	-236	-267

As a Percentage of GNP							
Individual Income Taxes	-1.0	-2.1	-3.0	-3.3	-3.7	-4.1	-4.5
Corporate Income Taxes	-0.3	-0.5	-0.7	-0.9	-1.0	-1.0	-0.9
Other	<u>b/</u>	<u>-0.1</u>	<u>-0.1</u>	<u>-0.1</u>	<u>-0.2</u>	<u>-0.2</u>	<u>-0.2</u>
Total	-1.3	-2.6	-3.9	-4.4	-5.0	-5.3	-5.6

a. Less than \$500 million.

b. Less than 0.05 percent.

The Tax Equity and Fiscal Responsibility Act of 1982 tax increases partly offset the revenue effects of ERTA by offsetting almost two-thirds of the ERTA corporate income tax reductions and about 10 percent of the ERTA individual income tax reductions. As shown in Table 12, TEFRA is projected to increase total revenues over what they would otherwise be by 1.1 percent of GNP in 1984 and 1.2 percent in 1988.

ERTA and TEFRA taken together produce a small but continual downward trend in revenues as a percent of GNP over the projection period. The combined net revenue reduction increases from 2.8 percent of GNP in

TABLE 12. REVENUE EFFECTS OF THE TAX EQUITY AND FISCAL RESPONSIBILITY ACT OF 1982 (By fiscal year)

	1982	1983 Base	Projections				
			1984	1985	1986	1987	1988
In Billions of Dollars							
Individual Income Taxes	--	5	13	12	15	18	20
Corporate Income Taxes	--	7	16	19	26	32	31
Social Insurance Taxes	--	2	3	4	3	3	2
Excise Taxes							
Windfall profit taxes	--	a/	a/	a/	a/	a/	a/
Other	--	4	5	6	2	2	2
Estate and Gift Taxes	--	--	a/	a/	a/	a/	a/
Total	--	18	38	42	47	54	56
As a Percentage of GNP							
Individual Income Taxes	--	0.2	0.4	0.3	0.4	0.4	0.4
Corporate Income Taxes	--	0.2	0.5	0.5	0.6	0.7	0.6
Other	--	<u>0.2</u>	<u>0.2</u>	<u>0.3</u>	<u>0.1</u>	<u>0.1</u>	<u>0.1</u>
Total	--	0.6	1.1	1.1	1.1	1.2	1.2

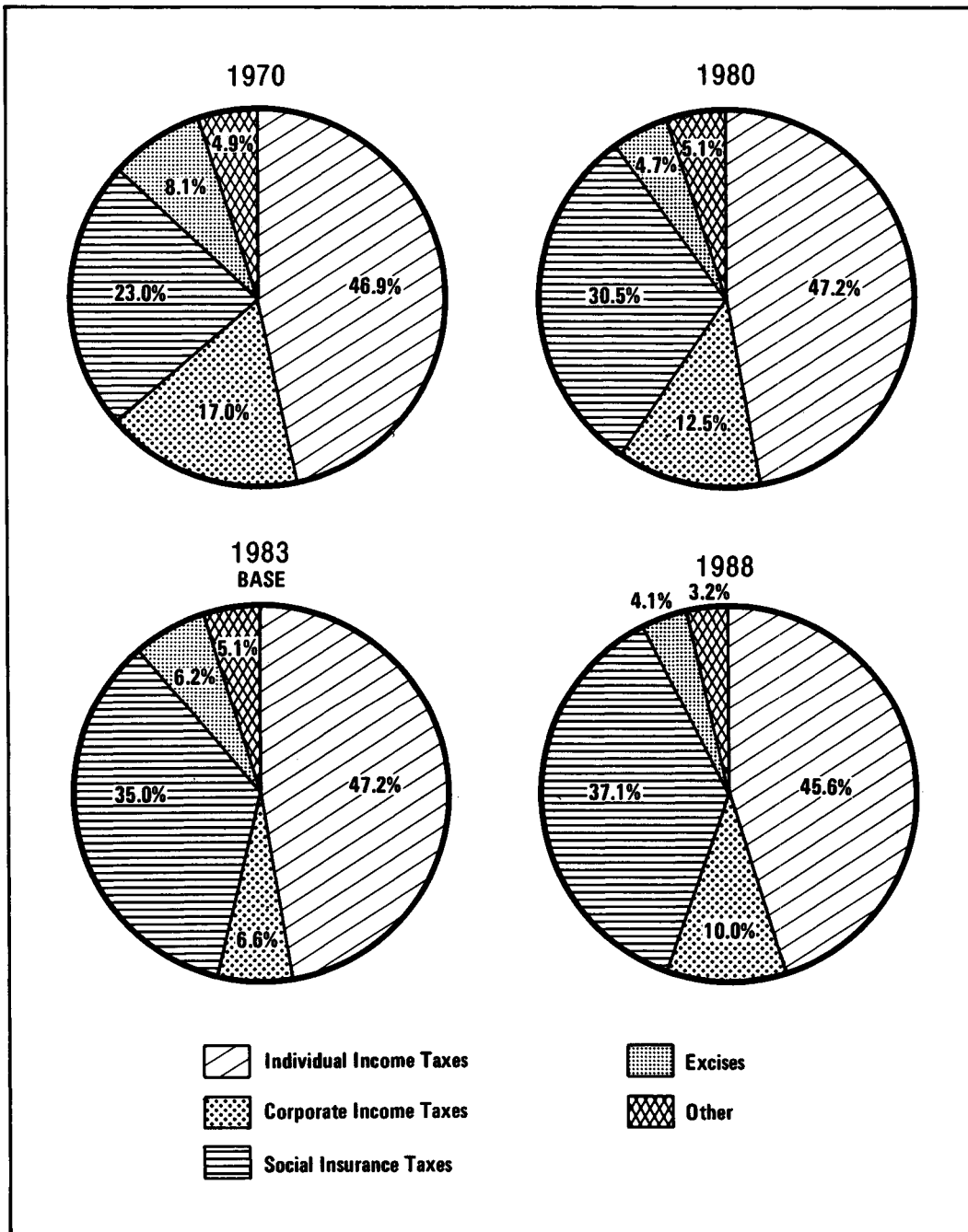
a. Less than \$500 million.

1984 to 4.4 percent of GNP in 1988. This is reflected in the projection of total revenues as a share of GNP, which declines from 18.7 percent in 1984 to 18.3 percent in 1988 (see Table 10).

Shifting Role of Different Tax Sources

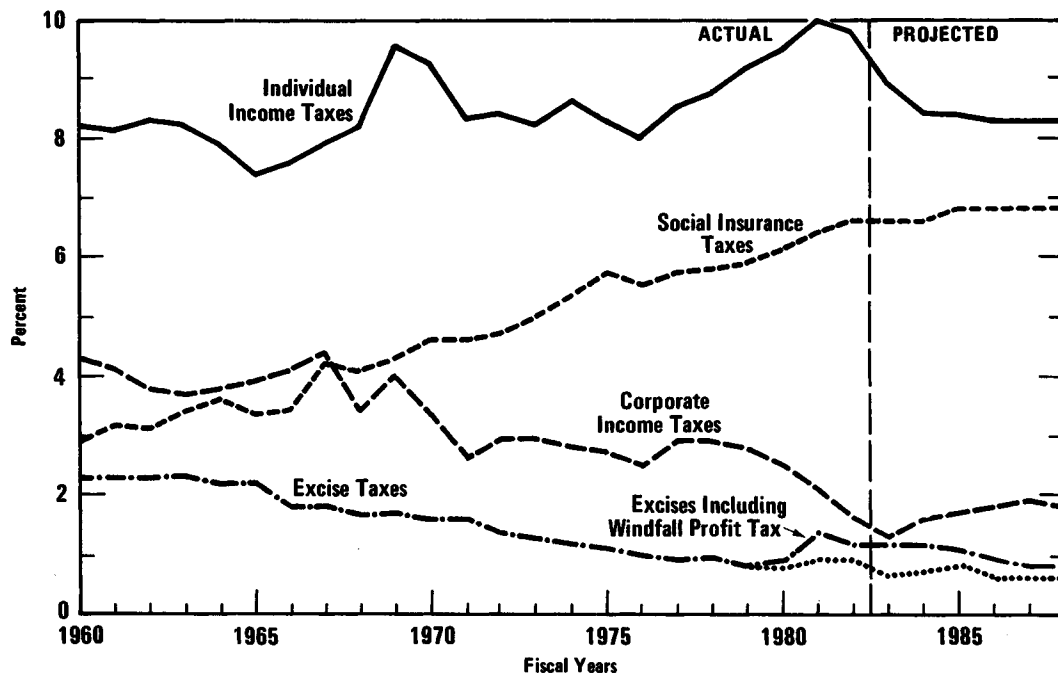
The shares of total revenues made up by different tax sources change over the period from 1980 to 1988, reflecting both changing economic conditions and legislative action (see Figure 5). The individual income tax share peaked in 1982 and is projected to drop substantially in 1983 and 1984 and then to remain relatively stable through 1988. The corporate income

Figure 5.
The Composition of Federal Revenues



tax share reaches its lowest level in 1983 and then increases until 1987 when it levels off. The social insurance tax share continues its rise through 1986, and then remains relatively stable, while all other taxes drop off somewhat during the projection period. These patterns, and some of the reasons for them, are discussed below.

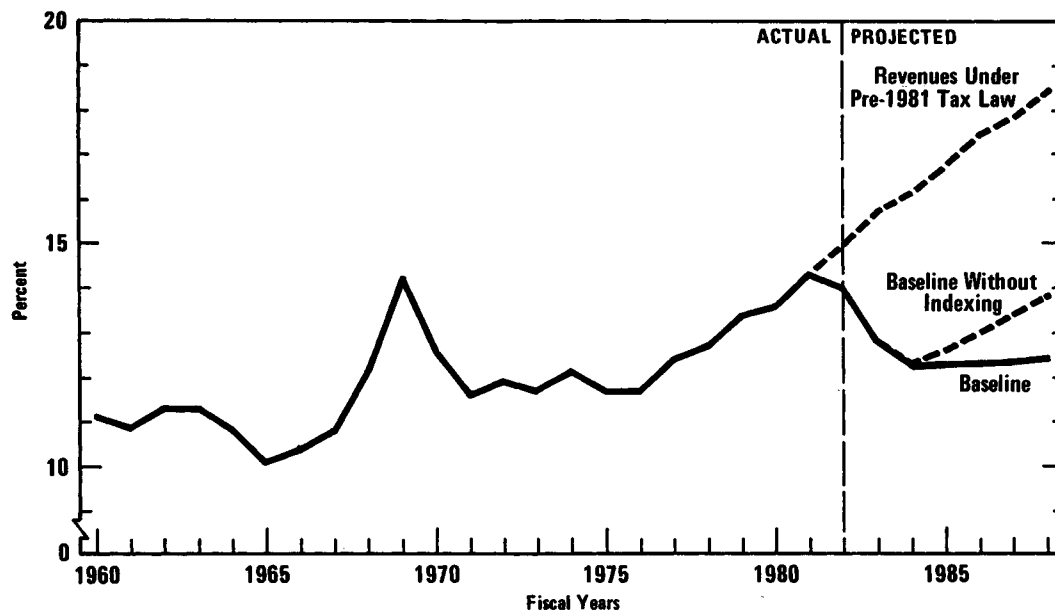
Figure 6.
Revenue Sources as a Percentage of GNP



Individual Income Taxes. Individual income taxes are projected to decline from their post-World War II peak of 10.0 percent of GNP, reached in 1981, to a level of 8.3 percent in 1986 through 1988 (see Figure 6). This is due largely to ERTA, which cut individual income tax rates by 23 percent in three stages over the period from 1981 to 1984, and instituted indexing of the individual income tax, starting in 1985. Indexing assures that individual income taxes will increase as a share of GNP only if real (adjusted for inflation) incomes also increase as a share of GNP.

Figure 7.

Individual Income Taxes as a Percentage of Taxable Personal Income



These changes in the individual income tax burden show up more sharply when effective individual income tax rates--individual income taxes as a percentage of taxable personal income--are calculated for the period. ^{1/} The rate declines steadily from 14.3 percent in 1981, the highest level since 1960, to 12.3 percent in 1984 as the ERTA across-the-board rate reductions are being put in place, and remains at this level as indexing is put into effect beginning in 1985. The rate then rises slightly, to 12.4 percent in 1987 and 1988, as the movement of taxpayers into higher tax brackets caused by real income increases begins to have a measurable effect. The average rate for the 1984-1988 period, 12.3 percent, is very close to the 12.2 percent average rate for the 1970s when the increase in the effective rate due to bracket creep was partially offset by legislated tax reductions.

As shown in Figure 7, in the absence of ERTA the projected rate would have continued to rise over the period to an unprecedented 18.4 percent by 1988. Without indexing, the rate would rise from the 12.3 percent level in 1985 to almost 14 percent in 1988.

1. Taxable personal income is defined as the sum of wages and salaries, proprietors' income, personal interest income, personal dividend income, and rental income.

Corporate Income Taxes. Corporate income taxes as a share of GNP are expected to reach a post-World War II low of 1.3 percent in 1983 before starting a gradual recovery to just under 2 percent that extends through the 1984-1988 projection period (see Table 10). This pattern reflects in part the effects of ERTA, which made major reductions in corporate income taxes by substantially increasing allowances for depreciation and the investment tax credit through a new Accelerated Cost Recovery System (ACRS). These corporate tax reductions were only partly offset the next year in TEFRA, which scaled back increases in depreciation allowances scheduled for 1985 and 1986, reduced depreciation allowances for equipment eligible for the investment tax credit, eliminated so-called "safe-harbor leasing," reduced the value of several corporate tax preferences by 15 percent, and tightened the tax treatment of certain specific categories of corporate income.

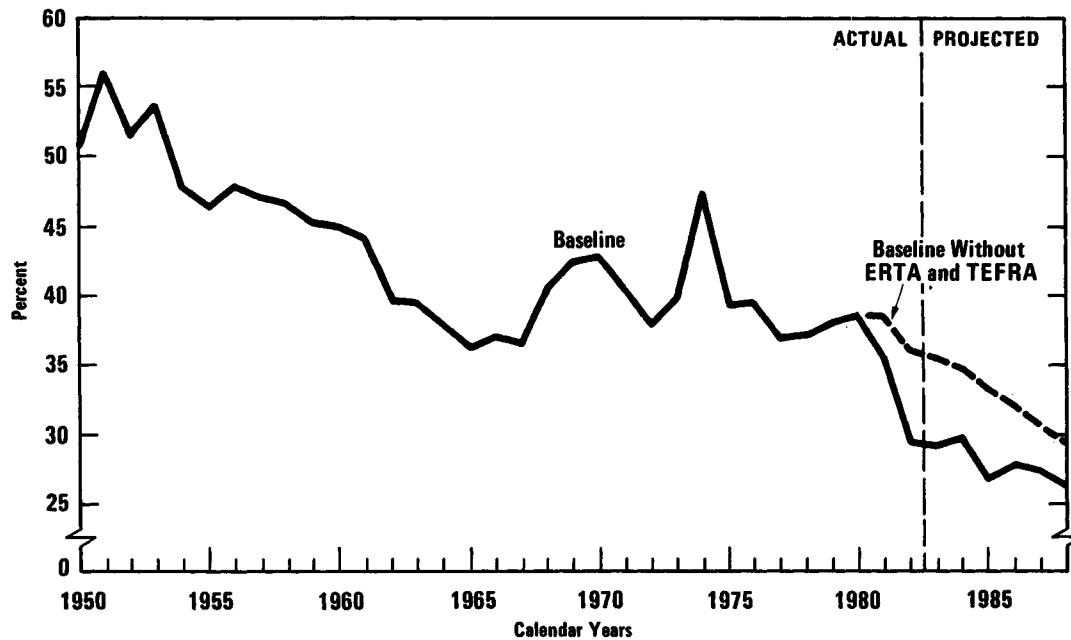
The pattern of declining corporate revenue through 1983, followed by a gradual upturn, also reflects the trend of corporate profits as a share of GNP. The corporate profit share of GNP declined fairly steadily between 1950 and 1982. It turns upward as the economy recovers during the projection period. This projected increase in corporate profits more than offsets a projected decline in the effective corporate tax rate over the 1984-1988 period, resulting in a steady increase in corporate income taxes over the period.

Figure 8 shows effective corporate tax rates--corporate income tax accruals (a National Income and Product Accounts measure) as a share of economic profits--from 1950 through 1988.

The effective corporate rate fell from over 50 percent to about 39 percent between 1950 and 1980, reflecting the adoption of accelerated depreciation in 1954, and the introduction of the investment tax credit in 1962 and of more accelerated methods of depreciation in 1971. The rate continues to trend down over the projection period, reaching a new low of 26.2 percent in 1988.

However, even without the substantial legislated corporate tax reductions of ERTA, the effective corporate tax rate would have steadily declined to a low of 29.3 percent in 1988. This decline would occur primarily because the moderate inflation contained in the CBO economic assumptions would mean slower growth in replacement costs of inventory and capital used in production, and thus less inflation-induced overstatement of profits. The tax reduction that results from accelerated depreciation grows both as the inflation rate declines and as the level of investment increases. For this reason, the accelerated depreciation already in the tax code before the ACRS would have reduced corporate taxes by increasing amounts throughout the forecast period, even if there had been no further legislated reductions.

Figure 8.
Corporate Income Tax as a Percentage of Economic Profits



NOTE: National Income and Product Account concepts.

Social Insurance Taxes. Social insurance taxes and contributions reflect mainly Social Security payroll taxes, which account for over 85 percent of the total. After a steady increase since 1950, social insurance taxes as a share of GNP are projected to stabilize in 1985 at 6.8 percent, more than twice the level that prevailed in the early 1960s. The recent increase in the GNP share is accounted for mainly by the major increase in Social Security taxes that was enacted in 1977. The bulk of this increase shows up in the period from 1978 to 1981, although some of the rate increases enacted in 1977 are not scheduled to take effect until 1985, 1986, and 1990. The effects of the 1985 and 1986 Social Security rate increases scheduled to go into effect during the projection period are shown in Table 13. These increases are relatively small, raising social insurance taxes and contributions as a share of GNP by only 0.2 percentage points from 1984 and 1988, and increasing social insurance as a share of total revenues by about 1.6 percentage points over the period.

TABLE 13. REVENUE INCREASES DUE TO INCREASES IN SOCIAL SECURITY TAX RATES (By fiscal year, in billions of dollars)

	1984	1985	1986	1987	1988
Increase from 6.7 Percent to 7.05 Percent, Effective January 1, 1985	--	8.2	12.1	13.0	14.0
Increase from 7.05 Percent to 7.15 Percent, Effective January 1, 1986	--	--	2.5	3.6	3.9
Total Increase	--	8.2	14.6	16.6	17.9

Excise Taxes. Excise taxes are projected to be 1.2 percent of GNP in 1984--about the same level that prevailed during the 1970s--and to drop to 0.7 percent in 1988. Excise tax revenues increased somewhat as a share of GNP in 1981 because of the enactment in 1980 of the Crude Oil Windfall Profit Tax. As shown in Table 9, windfall profit tax collections accounted for more than half of all excise tax collections in 1982, but are projected to decline both in dollar amounts and as a share of the total throughout the projection period, declining to about one-fourth of all excise tax collections by 1988. The decline in windfall profit tax collections is due primarily to the projected drop in real oil prices over the 1984-1988 period.

The other major reason for the decline in excise taxes after 1985 is that taxes on cigarettes were temporarily doubled and the tax on telephone service temporarily tripled in TEFRA. This boosts excise tax collections in 1984 and 1985, but drops them in later years when the cigarette tax reverts to its earlier levels and the telephone tax expires.

Other Taxes. All other taxes account for about 0.9 percent of GNP and 4.4 percent of total revenues in 1984, declining to about 0.6 percent of GNP and 3.2 percent of total revenues in 1988. Estate and gift taxes--about 20 percent of these other taxes--fall during the projection period because of legislated reductions in ERTA. Customs duties--about a third of other taxes--remain fairly steady. Federal Reserve System payments to the Treasury--about 47 percent of other taxes--decline somewhat, reflecting mainly the lower interest rates projected for the period.

EFFECT OF RECESSION AND TAX LAW CHANGES
ON REVENUE PROJECTIONS

Current CBO baseline revenue projections for the 1983 through 1986 period are about 30 percent lower than they were projected to be two years ago. For 1986, for example, the baseline revenue projections of July 1981 estimated revenues to be \$1,159 billion. The current CBO estimate for 1986 revenues is \$768 billion. This \$391 billion drop in projected revenues results from changes in economic conditions and from new tax legislation, both of which have had significant effects on revenue estimates (see Table 14).

**TABLE 14. DIFFERENCES BETWEEN JULY 1981 AND FEBRUARY 1983
 BASELINE REVENUE PROJECTIONS (By fiscal year, in billions
 of dollars)**

	1982	1983	1984	1985	1986
July 1981 Baseline Revenues	709	810	920	1,033	1,159
Differences Due to					
Changed economic outlook	-49	-132	-169	-191	-231
Legislative actions					
ERTA	-38	-88	-135	-167	-205
TEFRA	--	18	38	42	47
Other	--	2	4	4	4
Subtotal	-38	-68	-93	-121	-154
Technical estimating changes <u>a/</u>	-4	-4	-5	-6	-6
Total Differences	-91	-204	-267	-318	-391
February 1983 Baseline Revenues	618	606	653	715	768

- a. Reclassification of supplemental medical insurance premiums and voluntary enrollee premiums for Medicare coverage as offsets against outlays.

The assumptions on which the July 1981 baseline projections were based are the ones agreed upon by the conferees on the first budget resolution for fiscal year 1982. These assumptions were very optimistic about the prospects for real growth. After a pause in economic growth during the second and third quarters of 1981, it was assumed to pick up at a 4.1 percent rate in the fourth quarter of the year and to average 5.0 percent per quarter for the next two years, declining to 4.2 percent during 1984. This real growth path would have resulted in an unemployment rate of 7.0 percent in the fourth quarter of 1982, instead of the 10.7 percent actually experienced.

The July 1981 economic assumptions also incorporated higher rates of inflation (measured by the GNP deflator) than those actually experienced during the past year and a half, and higher rates for subsequent years than are assumed in the CBO February projections. These high assumed rates of real output and inflation would have generated GNP growth of 13.0 percent in 1982 instead of the 4.1 percent growth actually achieved during the year (See Table 7 in Chapter II).

If the July 1981 economic assumptions had held, tax law existing at that time would have generated very large increases in collections over the 1981 through 1986 period, pushing revenues up from 20.1 percent of GNP in 1980 to an unprecedented 23.9 percent of GNP by 1986. Most of this increase in revenues as a share of GNP would have been caused by increases in the individual income tax share generated by the interaction between rapidly rising incomes and the progressive income tax structure. Under the 1981 economic assumptions, individual income taxes as a share of GNP would have risen from 9.5 percent in 1980 (the highest level since 1944) to 12.7 percent in 1986.

The Effects of Tax Law Changes

As described earlier, the Economic Recovery Tax Act substantially reduced the revenue stream for 1982 and subsequent years. The Tax Equity and Fiscal Responsibility Act raised revenues in 1983 and subsequent years. The net effect of tax legislation since 1981, however, has been to reduce current and projected revenues significantly below what they would have been under prior tax law (see Table 14). If ERTA and TEFRA had not been enacted, revenues for 1986 would be approximately \$154 billion higher than they are now estimated to be.

The Effects of the Recession

The recession, which began in the third quarter of 1981 and was still much in evidence in the fourth quarter of 1982, caused revenue collections

in 1982 to fall considerably below projected levels. Revenues for 1982, based on the July 1981 economic assumptions, were projected to be almost \$50 billion higher than actual collections in 1982 (after adjustment for the ERTA reductions).

The recession has also lowered the revenue stream for the entire 1983 to 1986 period below what would have been generated under existing tax law by an economy that had not experienced such a severe economic slump. By 1986, revenues based on the July 1981 economic assumptions (after correction for new tax law changes) are well over \$200 billion higher than the current CBO revenue estimate for 1986.

This significant reduction in projected revenues for 1986 is not the product of different assumptions about economic growth during the later years of the projection period. In fact, the average rate of real economic growth now assumed by CBO for the 1984-1986 period is 0.1 percentage point higher than that assumed by the budget conferees back in July 1981. This reduction in outyear revenues is the product, for the most part, of the output and income growth lost during and immediately after the current recession.

The lower rates of inflation experienced in 1982 and now assumed for the projection period (relative to the July 1981 economic assumptions) have the effect of lowering personal income growth for the entire 1982 through 1988 period and of reducing the amount of "bracket creep" assumed to take place through 1984, before indexing goes into effect. After 1984, the indexation of the individual income tax brackets, personal exemptions, and the zero bracket amount makes revenue growth much less sensitive to inflation assumptions, because bracket creep due to inflation is substantially removed from the system.

CHAPTER IV. BASELINE SPENDING PROJECTIONS

The Congressional Budget Office estimates that 1983 budget outlays will equal \$800 billion. This figure represents 25.0 percent of the gross national product--a larger share of the GNP devoted to federal spending than in any year since World War II. Under the baseline assumptions, in which existing spending policies continue unchanged, federal outlays are projected to grow to \$1.15 trillion, but to decline to 23.9 percent of GNP by 1988. This rate of spending is still above that for all postwar years until 1982. The rise in outlays of roughly \$350 billion between 1983 and 1988 represents an increase of 43 percent, or 7.4 percent per year.

As federal outlays grow, their composition will change. The share of gross federal spending devoted to national defense and interest will rise, while the relative importance of entitlements and nondefense discretionary spending will fall. The largest component of the projected increase in outlays is for national defense programs, which are projected to grow by \$144 billion between 1983 and 1988, assuming the policies of the fiscal year 1983 budget resolution (see Table 15). This is an increase of 68 percent, or 10.9 percent per year. The share of defense spending in the budget is projected to grow from 26 percent in 1983 to 30 percent in 1988, as depicted in Figure 9. This is higher than the 1980 rate of 23 percent but lower than the 1970 figure of 39 percent.

The next largest component of spending growth is for entitlements and other mandatory spending--largely benefit payments for the aged, disabled, poor, and unemployed. This type of spending is projected to grow by \$125 billion, or 32 percent, over the next five years. Since entitlements are projected to grow less rapidly than total outlays, however, their share of gross spending is projected to decline slightly from 46 percent in 1983 to 43 percent in 1988.

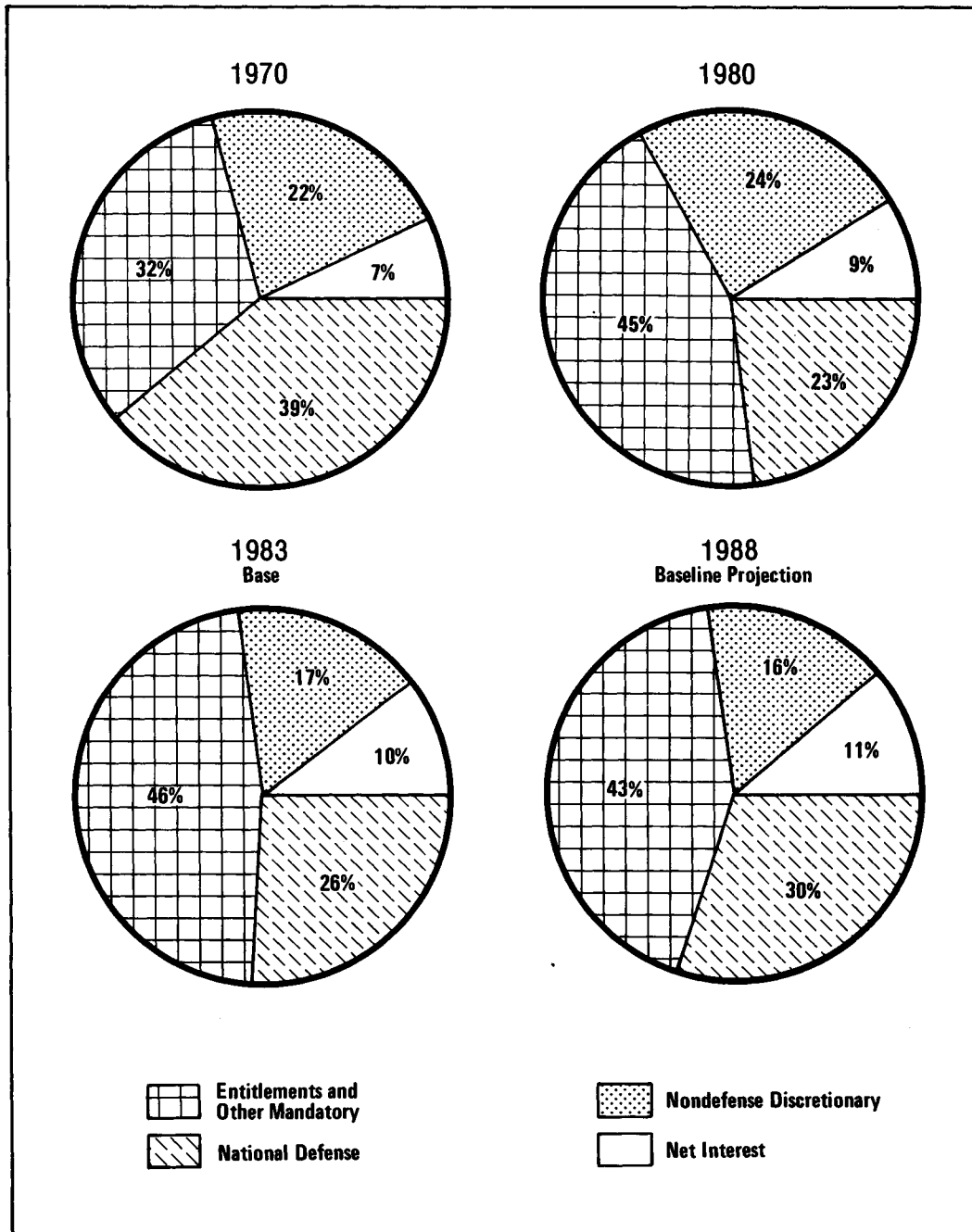
Net interest is projected to grow by 54 percent over the next five years. Because of large projected deficits, net interest outlays will increase from \$87 billion to \$134 billion between 1983 and 1988. The portion of gross spending devoted to interest will rise from 10 to 11 percent.

The remaining categories of spending are projected to shrink in importance over the projections period. Nondefense discretionary spending--a category that encompasses most of the day-to-day operations of the government--will increase from \$145 billion to \$184 billion, but its

TABLE 15. BASELINE OUTLAY PROJECTIONS FOR MAJOR SPENDING CATEGORIES
(By fiscal year)

	1982 Actual	1983 Base	Projections				
			1984	1985	1986	1987	1988
In Billions of Dollars							
National Defense	187	213	242	278	310	333	358
Entitlements and Other Mandatory Spending	344	386	394	418	444	477	511
Nondefense Discretionary Spending	137	145	153	162	169	177	184
Net Interest	85	87	96	107	117	125	134
Offsetting Receipts	<u>-25</u>	<u>-32</u>	<u>-34</u>	<u>-36</u>	<u>-41</u>	<u>-40</u>	<u>-41</u>
Total Budget Outlays	728	800	850	929	999	1,072	1,145
Off-Budget Federal Entities	<u>17</u>	<u>17</u>	<u>15</u>	<u>16</u>	<u>19</u>	<u>17</u>	<u>17</u>
Total Outlays	746	816	865	946	1,018	1,089	1,163
<hr/>							
As a Percent of GNP							
National Defense	6.2	6.7	6.9	7.3	7.5	7.5	7.5
Entitlements and Other Mandatory Spending	11.4	12.1	11.3	10.9	10.7	10.7	10.7
Nondefense Discretionary Spending	4.5	4.5	4.4	4.2	4.1	4.0	3.8
Net Interest	2.8	2.7	2.7	2.8	2.8	2.8	2.8
Offsetting Receipts	<u>-0.8</u>	<u>-1.0</u>	<u>-1.0</u>	<u>-0.9</u>	<u>-1.0</u>	<u>-0.9</u>	<u>-0.9</u>
Total Budget Outlays	24.0	25.0	24.3	24.3	24.1	24.0	23.9
Off-Budget Federal Entities	<u>0.6</u>	<u>0.5</u>	<u>0.4</u>	<u>0.4</u>	<u>0.4</u>	<u>0.4</u>	<u>0.4</u>
Total Outlays	24.6	25.5	24.7	24.7	24.6	24.4	24.3

Figure 9.
The Composition of Gross Federal Spending



budgetary share will fall from 17 percent to 16 percent. This would be substantially below its 1980 share of 24 percent. Offsetting receipts consist largely of government receipts from the public that are subtracted from gross spending instead of being counted as revenues; they are projected to increase from \$32 to \$41 billion. Off-budget outlays, which are largely for credit activities, are projected to be the same in 1988 as in 1983.

These same budgetary trends are evident in Figure 10, which shows outlays by spending category as percentages of GNP. National defense, which fell from 8.1 percent to 5.3 percent of GNP between 1970 and 1980, is projected to increase to 7.5 percent of GNP by 1988. Nondefense discretionary spending, on the other hand, which grew from 4.5 to 5.5 percent of GNP during the 1970s, will fall to 3.8 percent of GNP over the next five years.

Under baseline assumptions, 1983 will be the peak year for entitlements and other mandatory spending. This category, which equalled 6.7 percent of GNP in 1970 and 10.5 percent in 1980, is estimated to represent 12.1 percent of GNP in 1983. By 1988, however, it declines to 10.7 percent. In contrast, net interest will continue to represent a growing fraction of the nation's output.

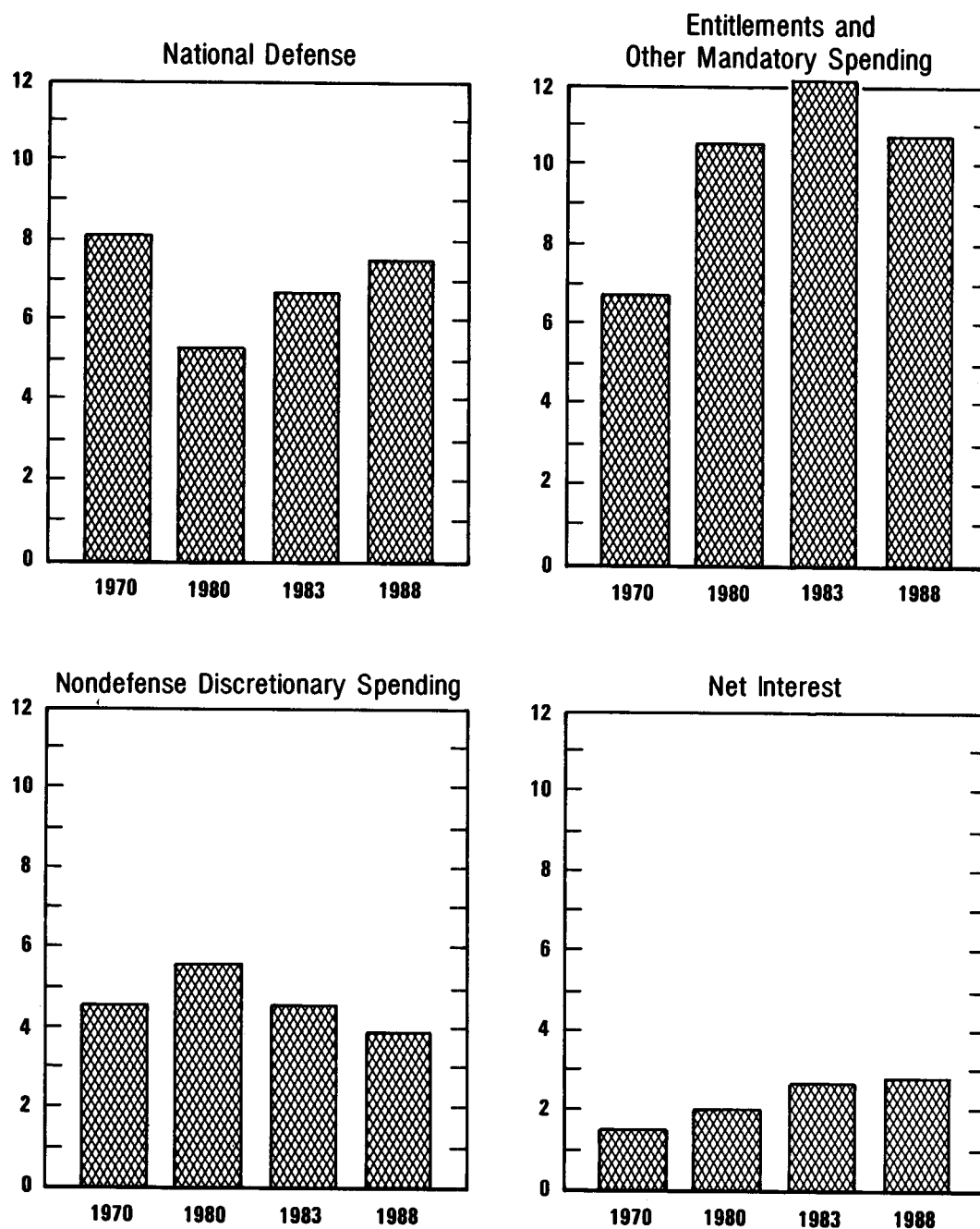
Presented in this chapter are further details on the CBO baseline spending projections for 1984-1988. The discussion is structured in terms of the budgetary categories that were used by the Congress in preparing the 1983 budget resolution. These categories are also used to organize the forthcoming CBO report on strategies for reducing the federal deficit. ^{1/} The distribution of spending in terms of the major program categories used in previous baseline projections reports may be found in Appendix A.

NATIONAL DEFENSE PROGRAMS

National defense programs include not only the military activities of the Department of Defense but also the nuclear weapons programs of the Department of Energy and miscellaneous defense activities, such as defense stockpiles and selective service. The baseline totals for the national defense function are CBO's extrapolation of the fiscal year 1983 Congressional budget resolution. The baseline projections may be divided into two parts: (1) funding for an explicit defense force structure and

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1. Congressional Budget Office, Reducing the Deficit: Spending and Revenue Options (February, 1982).

Figure 10.
Outlay Categories as Percentages of GNP



procurement program that, CBO assumes, were approved during the second session of the 97th Congress; and (2) an additional funding increment to cover cost increases and other program additions not yet publicly specified.

Table 16 divides the baseline outlay projections for National Defense into its major components. The category as a whole is projected to grow by \$144 billion in the next five years. About \$60 billion of this is due to rising procurement outlays, about a third of which stems from inflation and two-thirds from projected modernization of strategic and tactical forces.

TABLE 16. BASELINE OUTLAY PROJECTIONS FOR NATIONAL DEFENSE (By fiscal year, in billions of dollars)

	1983	1984	1985	1986	1987	1988
Military Personnel	45	45	46	46	47	48
Military Retired Pay	16	17	18	19	20	21
Operation and Maintenance	64	68	70	72	75	79
Procurement	55	66	80	94	104	115
Research, Development, Test, and Evaluation	21	24	25	24	24	24
Civilian and Military Pay Raises	--	3	6	9	13	17
Other Department of Defense	7	7	8	9	10	10
Atomic Energy and Defense-Related Activities	6	6	7	7	7	8
Unspecified Increment	<u>--</u>	<u>5</u>	<u>18</u>	<u>30</u>	<u>33</u>	<u>37</u>
Total	213	242	278	310	333	358